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Money Matters

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The November Forecast of Revenues and Expenditures

This paper examines the forecast of revenue and expenditure prepared by the Department of Finance and released on December 2, 1997. It is important to note that these estimates are based on the requirements of current law. They are not predictions of what the Legislature and Governor will eventually adopt as funding levels in the upcoming sessions.

Forecasted Surplus Exceeds $1.3 Billion

The General Fund forecast released by the Department of Finance on December 2, 1997 projects that $1.328 billion more will be available by the end of the current biennium (FY98-99) than was projected at the end of last session. The amounts now forecast before current law allocation from forecast balances are as follows. Revenues available for FY98-99 are now forecast at $21.045 billion and expenditures are forecasted at $20.699 billion, with $350 million set aside in the cash flow account, $522 million in the budget reserve account, $46 million in the property tax reform account, $93 million in dedicated revenue and an ending balance of $1.360 billion.

Action taken in the 1997 regular session and special sessions allocates available dollars from the November forecast. The table below shows the calculation of the surplus and a comparison of the revenues and expenditures between the end-of-session and November forecasts(before the current law allocations).

Table 1.
FY98-99 Forecast Expenditure and Revenue

($'s in millions)	**End-of-Session**	**Nov. 1997**	**$ Change**	**% Change**
Beginning Balance	$1,631	$1,995	$364	+22.3
Forecast Revenue	$20,316	$21,045	$729	+3.6%
Forecast Expenditure	$20,925	$20,669	$(256)	-1.2%
Reserve Account	$522	$522	$0	
Cash Flow Account	$350	$350	$0	
Dedicated Reserve	$72	$93	$21	
Property Tax Reform	$46	$46	$0	

Balance	$32	$1,360	$1,328	

Actions taken in the 1997 session created an account to fund additional property tax reform. Any forecasted surplus is directed first toward the general fund budget reserve of $522 million, then $81 million to an increase in the working family tax credit and the education tax credit and deduction, and 60 percent of the remainder is deposited in the Property Tax Reform Account. M.S. 16A.1521 directs that dollars in the Property Tax Reform Account may be spent only on property tax class rate compression, increasing education aids, increasing the state's share of education funding, increasing the Education Homestead Credit, or increasing the property tax refund. The $826 million estimate of dollars for the Property Tax Reform Account includes $59 million worth of interest on the account. All or only a portion of this amount would be available depending on the timing of any appropriations from the account. The balance remaining after these allocations is $453 million. The chart below tracks the allocations of the forecast balance.

Table 2.
Current Law Allocations of FY98-99 Forecast Balances
($'s in millions)

Forecast Balance	$1,360
Current Law Allocations:	
Education Tax Credit/Deduction	$81
Property Tax Reform Account	$826
Balance After Allocations	$453

Economic Summary and Outlook

The positive changes expressed in this forecast as compared to the forecast in February are due primarily to changes in the expected rate of Gross Domestic Product(GDP). The February control forecast from Data Resources Inc.(DRI) called for real GDP to grow in 1997 at a rate of 3.0 percent. The GDP estimate for 1997 in the current forecast is for growth of 3.3 percent. The current control forecast calls for the economy to continue at near this rate of growth through the end of the FY98-99 biennium.

The inflation outlook for FY98-99 has been lowered in the November forecast. DRI is forecasting that inflation as measured by the consumer price index(CPI) will be 2.5 percent annually for the period. This allows for a forecast of low interest rates and economic growth continuing at a higher rate than the February forecast.

Forecast of Revenues

FY97 Ends on a High Note

Minnesota closed its books on FY97 with $272 million more in revenues than the amount predicted at the end of the 1997 legislative session, a 2.7 percent increase. Of the total, the four major state taxes realized $233 million in revenues above the end-of-session estimates, and minor taxes and transfers brought in an additional $39 million.

The individual income tax accounted for about three-fourths of the unanticipated new revenues. Tax Year 1996 tax returns filed last spring had higher than expected settlement payments and smaller than expected refunds. Income tax receipts for tax year 1996 out paced forecasters' expectations by $206 million, or about 5 percent of estimated liabilities. FY97 general sales and use tax revenues were off by $27.7 million, but sales of cars and light trucks out paced forecast expectations yielding 6.4 percent ($24.3 million)more in motor vehicle sales tax revenues than the end-of-session expectations. Corporate tax revenues also came in above the estimates.

Higher income tax receipts were powered by capital gains — approximately half coming from profits on the sale of stock and mutual funds, and half from the sale of property and businesses. Analysts estimate that roughly $60 million of the unexpected income tax revenue stems from one such business sale, a "one-time event" that will not generate ongoing tax revenue. Workers got better wage gains than the forecasters predicted, the value of retirement savings and pensions was up "substantially," and the forecast economists believe that in 1996 more companies added non-qualified stock options to their compensation packages.

Table 3.
FY97 Actual Receipts vs. End-of-Session Estimates
November 1997 Forecast

Revenues **Amounts before dedications:** **($ in thousands)**	**End of Session Estimates**	**Actual FY97 Closing**	**$ Difference**	**Percent Variation**
Individual Income	$4,540,000	$4,768,390	$228,390	5.03%
General Sales and Use	$3,040,428	$3,012,746	($27,682)	-0.91%
Corporate	$671,600	$680,898	$9,298	1.38%
Motor Vehicle Sales Tax	$377,500	$401,751	$24,251	6.42%
Subtotal, "Big Four" Taxes:	***$8,629,528***	***$8,863,785***	***$234,257***	***2.71%***
Other Revenues	$943,466	$974,399	$30,933	3.28%
Dedicated Revenues	$130,255	$139,517	$9,262	7.11%
Transfers in	$206,736	$215,149	$8,413	4.07%
Prior Year Adjustments	$20,450	$9,501	($10,949)	-53.54%
Total, Current Resources:	***$9,930,435***	***$10,202,351***	***$271,916***	***2.74%***

Data Source: Minnesota Department of Finance, 1997 November Forecast, page 66.

Revenue Expectations for the Current Biennium Surge with Rising Economic Tide

The state economists added $684 million (3.6%) to the FY98-99 biennial forecast of General Fund non-dedicated revenues, bringing the anticipated total to $20.225 billion, compared to the end of session estimate of $19.541 billion. FY98-99 non-dedicated General Fund net revenues are expected to grow by 7.4 percent over the FY96-97 biennium, taking the $500 million dollar property tax rebate into account as a reduction in the FY98 income tax. Without the rebate, FY98-99 revenues would have been 10.1 percent greater than FY96-97.

Most of the new revenue for the current biennium, $616 million, is from growth in the four major state taxes. Continuing the trend of FY97, about 75 percent of new revenue is derived from the individual income tax as the economy far outperforms the previous forecast, particularly in the value and capitalization of assets. While the general sales and use tax forecast essentially is unchanged, there is a major upward adjustment in anticipated taxes from motor vehicle sales. Corporate taxes also are expected to grow at a higher rate than previously thought. A small net gain in the combined yield of the minor taxes, non-tax revenues and transfers make up the balance of the new revenue.

Table 4.
Forecast Revenue Changes
End-of-Session vs. November Forecast

Revenues ($ in millions) **Amounts before dedications:**	**FY97**	**FY98**	**FY99**
Individual Income	$228	$201	$255
General Sales & Use	$(28)	$(5)	$3
Corporate	$9	$62	$38
Motor Vehicle Sales	$24	$43	$20
Subtotal, "Big Four" Taxes:	***$233***	***$301***	***$316***
Other Tax & Non-tax Revenues	$32	$30	$39
Transfers, Misc.	$7	$35	$9
Total Change:	***$272***	***$366***	***$364***

Source: MN Department of Finance, November Forecast (1997), page 5.

The FY99 income tax figures shown in Table 4 (above) are not reduced by the new education tax credits and deductions, since those provisions, enacted in the first special session of 1997 were contingent on a revenue surplus in this forecast.

Table 5 shows the FY98-99 end of session budget estimates, the November forecast revisions including a carryforward of the $364 million closing balance from FY97, and the impacts of legislation enacted in the 1997 first special session on the FY98-99 bottom line revenues. From an initial $1.360 billion initial forecast balance, $81 million is subtracted from projected individual income tax receipts to account for the education credits and deductions and increased Working Family Tax Credit, beginning in Tax Year 1998 (FY99). Next, of the remainder, 60 percent or $767 million plus $59 million of dedicated interest are set aside in the Property Tax Reform Account. Thus, $453 million of new revenue is the **unrestricted** balance for the biennium.

Table 5.
FY 1998-99 Budget Summary

($ in millions)	End of Session Estimate	November Forecast	Change
Beginning Balance	**$1,631**	**$1,995**	**$364**
Forecast Revenues	$19,541	$20,225	$684
Other Resources	$775	$820	$45
Estimated Expenditures	$20,925	$20,669	($256)
Cash Flow Account	$350	$350	--
Budget Reserve	$522	$522	--
Dedicated Revenue	$72	$93	$21
Property Tax Reform Account	$46	$46	--
Forecast Balance	$32	$1,360	$1,328
Statutory Allocations —	**EOS Estimate**	**11/97 Forecast**	**Change**
Education Tax Credits/Deductions	--	*($81)*	*($81)*
Property Tax Reform Account	--	*($767)*	*($767)*
-- *PTRA Dedicated Interest*	--	*($59)*	*($59)*
Available Balance	**$32**	**$453**	**$421**

Source: Minnesota Department of Finance, *1997 November Forecast*, page 35.

Revenues by Type of Tax

Table 6.
FY 1998-99 Revenue Forecast

Revenues ($ in Millions)	FY 1996-97	FY 1998	FY 1999	FY 1998-99	Biennium- to-Biennium $ Difference	% Difference
Individual Income Tax	$8,904	$4,361	$5,118	$9,479	$575	6.5%
Sales Tax	$5,914	$3,194	$3,353	$6,547	$633	10.7%
Corporate Income Tax	$1,383	$758	$750	$1,509	$126	9.1%
Motor Vehicle Sales Tax	$783	$403	$394	$797	$14	1.8%
Subtotal, Four Major Taxes:	***$16,984***	***$8,717***	***$9,615***	***$18,332***	***$1,348***	***7.9%***
Other Revenues	$1,842	$953	$940	$1,893	$51	2.8%
Net Non-dedicated	***$18,826***	***$9,670***	***$10,555***	***$20,225***	***$1,399***	***7.4%***
Other Resources	$777	$430	$390	$820	$43	5.5%

Current Resources:	***$19,603***	***$10,100***	***$10,945***	***$21,045***	***$1,442***	***7.4%***

Source: MN Department of Finance, 1997 November Forecast, page 37.

Individual Income Tax Is the Main Source of New Revenues — and Uncertainty

Individual Income Tax receipts in FY98-99 are now forecast to total $9.479 billion, exceeding FY96-97 revenues by $575 million (6.5 percent). The income tax revenue estimates for FY97 are revised upward from the end-of-session estimates based partly on tax year 1996 receipts and partly on new expectations of higher and sustained economic growth and high employment.

Roughly 40 percent of the FY98-99 forecast increase comes about by carrying forward the "sustainable" growth in the 1996 income tax base into tax years 1997, 1998 and 1999. Just less than 40 percent is related to the continued high performance of capital markets and a high level of capital gains realizations. Increases in wage and salary income, taxable pensions and retirement income, and fiduciary returns tax explain about 20 percent of the forecast revision.

The November income tax forecast for FY98-99 is **uncertain**. One of the economists observed that forecasting "is becoming more and more difficult as the income tax moves farther away from the real economy," in that the major sources of revenue growth — capital gains, pensions and executive compensation — are not included in calculations of the Gross Domestic Product.

The forecast assumes that the stock market will remain strong and that the higher level of all types of capital realizations observed in 1996 is an ongoing trend rather than a one-time event. The state economists based the capital gains estimates partially on information from 1996 U.S. tax returns. Those federal returns brought in 10 percent more revenue than the U.S. Treasury Department's FY97 forecast, a large part of which is unexplained "mystery money." Minnesota-specific 1996 capital gains data from actual returns will not be available until January 1998. Another forecast wild card is anticipating how strongly and when investors and asset holders will respond to recent reductions in the federal tax rate on capital gains and changes in federal tax incentives for IRA savers.

The forecasters may revise the income tax projections based on information to be gleaned from 1996 state income tax returns. In addition, forecasters are keeping a close eye on estimated tax payments (to resolve some of their uncertainty about investors' responses to the recent federal tax act that lowered the tax rate on capital gains income) and withholding for the final quarter of this tax year. ***If the declarations or withholding are much higher or lower than projected in the November forecast, the income tax forecast could change substantially in February.***

Sales and Use Tax revenues are forecast to reach $6.547 billion in FY98-99, or $2 million (0.03 percent) below the end of session estimate. Actual sales tax receipts net of refunds have lagged below forecast levels for more than a year now, so the economists slightly lowered the underlying demand assumptions, as a permanent base adjustment. They also increased the estimate for sales tax refunds by $7 million over the February forecast. In the November forecast, expectations of overall slow growth in consumer demand offsets projected increases in spending for both consumer and producer durables. On a biennium-to-biennium basis, general sales tax revenues are forecast to increase by 10.2 percent.

Corporation Income Taxes are forecast to yield $1.509 billion in FY98-99, or $100 million (7.1 percent) more than the end-of-session estimate. The historical base data on corporate profits was revised upward based on new data. Higher than anticipated corporate profits in FY97 also contributed to the increase in forecast revenues. Corporate taxes are the least predictable and most volatile of the major taxes and greater, or lower, than expected economic performance could cause another swing in tax receipts.

Ongoing litigation under the Cambridge Bank case continues, adding uncertainty to this forecast. Several refund cases that are being litigated "could add materially to the expected final liability" for corporate income taxes. (Settled judgments are accounted for as spending from the Cambridge Bank fund. To date about 95 percent of estimated liability, or $204 million has been paid.)

The Sales Tax on Motor Vehicles (STMV) is forecast to generate $797 million in FY98-99, or $63 million (8.5 percent) more than the end of session estimate for the current biennium. DRI's February forecast substantially underestimated actual car sales. Minnesota tax receipts in the first four months of FY98 are 25 percent above prior estimates. The November 1997 forecast of STMV revenue includes this adjustment. Analysis of auto and truck sales reveal a change in purchasing patterns, which may lead to a February forecast adjustment after further study of the auto sales data.

Other tax and non-tax revenues now are forecast to bring in $1.893 billion for the current biennium, an increase of $67 million (3.8 percent) above the end of session estimate. Rising home prices and refinancing add $19 million to the forecast for the mortgage and deed taxes. Forecasters added $86 million to estimated interest income. Those increases offset a decline in anticipated receipts from healthcare provider taxes, lawful gambling taxes and revenues collected at regional treatment centers.

Planning Estimates of Revenues for FY 2000-01

Planning estimates now anticipate that FY00-01 revenues will reach a total $23.020 billion after subtracting $171 million from TY99-2000 individual income tax receipts to account for the new education tax provisions and the increased Working Family Tax Credit. This estimate is 9.8 percent more than the forecast for the current biennium.

Table 7.
FY 2000-01 Revenue Planning Estimates

Revenues ($ in Millions)	FY 1998-99	FY 2000	FY 2001	FY 2000-01	Biennium-to-Biennium $ Difference	% Difference
Individual Income Tax	$9,479	$5,393	$5,634	$11,027	$1,548	16.3%
Sales Tax	$6,547	$3,507	$3,656	$7,163	$616	9.4%
Corporate Income Tax	$1,509	$776	$826	$1,603	$94	6.2%
Motor Vehicle Sales Tax	$797	$403	$415	$818	$21	2.6%
Subtotal, Four Major Taxes:	***$18,332***	***$10,079***	***$10,531***	***$20,610***	***$2,278***	***12.4%***
Other Revenues	$1,893	$900	$909	$1,809	$(84)	-4.4%
Net Non-dedicated	***$20,225***	***$10,979***	***$11,440***	***$22,419***	***$2,194***	***10.8%***
Other Resources	$820	$368	$404	$722	$(98)	-12.0%
Current Resources:	***$21,046***	***$11,347***	***$11,844***	***$23,191***	***$2,145***	***10.2%***

Source: MN Department of Finance, 1997 November Forecast, page 55.

Planning estimates of revenues and expenditures are used for forward budget planning and to analyze the structural balance/ imbalance of revenues and expenditures and other long term budget trends. These revenue figures are more aptly described as “projections” than as “estimates” in that they differ from those used for the budget forecast both in methodology and reliability. The Department of Finance is considering the use of DRI’s 5 Year Control forecast as a base for long term planning estimates, but continues to use the current methodology at this time. No change would be undertaken until at least the November 1998 forecast.

Forecast of Expenditures

Forecast and Planning Estimates Include Inflationary Adjustments

In making its forecast of expenditures the Department of Finance(DOF) must assume the continuation of current law. In addition, the DOF makes adjustments based on estimates of variables outside the control of the legislature, primarily caseload changes. For FY00-01 the forecast also applies a discretionary inflation adjustment of 2.5 percent per year to the estimate of expenditures. This discretionary inflation is forecasted in the FY00-01 expenditures at $779 million. The actual inflationary increase proposed by the governor or adopted by the Legislature for that period may differ substantially from the rate used in the November forecast.

Forecast Estimates FY98-99 Expenditures at $20.669 billion

In its forecast DOF now estimates total General Funding expenditures for FY98-99 to be $20.669 billion. This is a reduction in forecasted expenditures of $256 million below the end of session estimate. The largest area of reduced expenditures is in human services spending. The table below compares the estimate of expenditures by the major spending categories.

Table 8.
FY98-99 Forecasted General Fund Expenditures by Major Category

($’s in millions)	End of Session	November	$ Change	% Change
Education Finance	$6,885.5	$6,852.5	$(32.9)	(.5)%
Property Tax Recognition	18.7	18.7	$0.0	0%
Post-Sec. Education	2,370.1	2,377.2	7.2	.3%
Property Tax Aids & Credits	2,611.1	2,590.1	(20.9)	(.8)%
Other Major Local Assistance	1,000.1	980.3	(20.5)	2.0%
Health Care	3,571.6	3,334.8	(236.8)	(6.6)%
Family Support	584.7	552.5	(32.2)	(5.5)%
State Operated Institutions	893.3	891.7	(1.7)	(.2)%

Legislature, Judicial & Constitutional	478.1	484.7	6.6	1.4%
State Agencies	1,706.8	1,731.5	24.7	1.4%
Debt Service	582.4	581.0	(1.4)	(.2)%
Dedicated Expenditures	241.6	294.1	52.5	21.7%
Cancellations	(20.0)	(20.0)	0.0	0%
Total	$20,924.6	$20,669.0	$(255.5)	(1.2)%

Expenditure Details by Category

Education Aids spending for FY98-99 is forecasted to decrease by $33 million compared with projected spending at the end of the 1997 Legislative session. The savings are split evenly between the general education program and special education. The largest general education reduction is due to pupil count reductions, which account for about $8 million of the $33 million. The largest categorical savings comes in special education, which is expected to cost $19 million less than projected at the end of the session, with about $15 million of that coming from reductions in expected special education excess cost spending.

Post-Secondary Education expenditures for the FY98-99 are forecasted to increase by $7.2 million over the end of session estimate of spending. Most of this change is technical in nature. Approximately $3.5 million is carryforward from the FY96-97 biennium for specific items at the Minnesota State Colleges and Universities(MnSCU). In addition, adjustments due to the pension conformity act of 1997 which changed system retirement contributions to the Teachers Retirement Association, and an increase in dedicated interest on MnSCU's tuition and fee income contributed to the forecast change.

Property Tax Aids and Credits are forecasted to decrease $39 million from the end of session estimate in FY98-99.

Other Major Local Assistance, which includes a variety of programs spread across state agencies, is now projected to decrease by $20.5 million from the end of session estimate in FY98-99.

Health Care spending is now forecasted $236.8 million lower than end of session estimates for FY98-99. Projected expenditures in FY98-99 in all four broad categories of the medical assistance (MA) program are expected to be less than originally anticipated. MA costs for MFIP & families basic care and aged & disabled basic care are projected to decline by $71 million and $66 million, respectively. These reductions are attributable to a combination of caseload reductions and lower than average costs of care.

Spending on MA long-term care also is less than originally forecast. Unlike the basic health care programs, however, the reduction in projected spending on long-term care is primarily due to caseload changes. For instance, projected caseloads for MA long-term care facilities are expected to be less 2.0% less than originally forecast. Estimated MA spending for long-term care facilities and long-term care waiver programs are each down $23 million from end of session estimates.

Projected spending in the General Assistance Medical Care program is expected to decline by $47 million during the biennium. Half of the savings is due to a 13% downward revision of caseload projections in this program. In addition, chemical dependency treatment program spending is projected to be $7 million less than previously estimated.

Family Support spending in the November forecast is estimated to be $32.2 million less than estimated in the end of session fund balance. The change is primarily due to the continuing strength of the state's economy, although a significant proportion of the savings reflects the federal government's decision to restore Supplemental Security Income payments to legal non-citizens. Items changing in the forecast include and increase of $6.4 million in the Department of Children, Families and Learning for child care assistance. Increased child care spending is attributable to a projected growth in participation for the Minnesota Family Investment Program-Statewide transition year child care program in FY99.

State Operated Institutions spending is forecast to decrease by $1.7 million from the end of session estimate for FY98-99. Contributing to this change is a decrease in the estimated population in institutions.

FY2000-01 Planning Estimates

As part of the November forecast the Department of Finance is required to prepare estimates of current law revenues and expenditures for the biennium beyond the current budget years. The revenue planning estimates are based on long term forecasts for the output of the Minnesota economy through the planning period. Expenditure estimates are based on current laws and forecast through the period as if laws were to be unchanged. The forecast of expenditures are adjusted from the base amount by an estimate of caseload changes and contain an inflationary adjustment factor .

Table 9.
FY2000-01 Planning Estimates

($'s in millions)	FY98-99	FY2000-01
Beginning Balance	$1,995	$2,289
Forecast Revenue	20,964	23,020
Estimated Expenditures	20,669	22,220
Balance	2,290	3,089
Dedicated Reserves(MnSCU)	93	61
Cash Flow Account	350	350
Property Tax Reform Account	872	872
Budget Reserve	522	522
Ending Balance	$453	$1,284

The long term planning estimates make no assumptions regarding the actions of the Governor or the Legislature on the budget during upcoming sessions. They give an estimate of the balance of the current law revenues to the current law expenditures. The long term planning estimate are useful to the Legislature in determining if the current structure of state expenditures is supportable by the trend projections of the current revenue system. It is significant to note that the current forecast indicates that the State budget is projected to be at a surplus for the current biennium and at the end of the next. The planning estimates for FY00-01 are for current revenue to exceed current expenses by $800 million.

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